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Tax alert: Insurance claim received by foreign parent towards erosion of financial interest in Indian subsidiary not taxable in India: ITAT

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Summary

The Income-tax Act, 1961 (Act) provides[1] that income shall be deemed to accrue or arise in India if it is from any business connection in India or through or from any property in India or from an asset or source of income in India. The Delhi Bench of the Income Tax Appellate Tribunal (ITAT) in a recent decision[2] held that insurance compensation received by a foreign parent under a Global Insurance Policy (GIP) towards erosion of financial interest held in its Indian subsidiary due to loss of stock by fire at the subsidiary's premises is not taxable in India, as the income does not accrue or arise in India.

Facts of the case

- The taxpayer, an Indian resident company, was engaged in the business of sourcing, distribution and marketing of certain branded products in India.
- For the assessment year 2010-11, a survey was carried out at the taxpayer's premises, wherein it was observed that the taxpayer had lost stock costing INR 72 crore and some fixed assets in a fire accident.
- The taxpayer had a fire insurance policy with an Indian insurer, from which a claim of INR 48.25 crore (covering both loss of stock in trade and fixed assets) was settled in favour of the taxpayer.
- The survey also revealed that the taxpayer's ultimate holding company, which was a tax resident of Germany, had received INR 91 crore under a GIP with its overseas insurer. The claim under the GIP was settled after providing a deduction for the taxpayer's claim from the Indian insurer.
- The Assessing Officer (AO) held that the GIP was in respect of the taxpayer's stock in trade and hence, the insurance claim received abroad by the holding company should have been offered to tax by the taxpayer in India.
- The Dispute Resolution Panel (DRP) upheld the AO's findings.
- The DRP observed that the overseas insurer had accepted the parent company's claim basis the value of the taxpayer's assets destroyed in the fire. Thus, the DRP concluded that the amount received abroad is inseparably connected with the conduct of the taxpayer's business, and the assets employed

[1] Section 9(1)(i) of the Act
[2] Adidas India Marketing (P.) Ltd v. ITO [ITA No. 1431/Del/2015]

therein in India and it is therefore chargeable to tax under the provisions[3] of the Act.

- The DRP was also in agreement with the AO's finding that the taxpayer has devised a mechanism to avoid taxes in India on the portion received abroad.

Taxpayer's contentions

- The taxpayer submitted that the GIP was taken by the parent company to cover loss of financial interest due to erosion of economic value of its subsidiaries globally. It was separate from the insurance policy which the taxpayer had taken on its assets in India.
- It was argued that as per the laws in Germany, the parent company was not allowed to take an insurance policy on the assets of its foreign subsidiaries. Since it had financial interests in the taxpayer as well as other subsidiaries worldwide on account of investments made therein, it obtained an insurance policy for protecting its financial interests in the subsidiary companies.
- The GIP was taken for covering the parent companies' risk in investment in subsidiaries across the globe and was not particularly with respect to the Indian subsidiary.
- It was contended that the entire cost of the GIP was borne by the parent company and no part of the cost was cross-charged or allocated to the taxpayer. Also, the taxpayer was not privy to the GIP contract which was entered into between the two foreign parties. Thus, it was argued that the taxpayer did not have any right or obligation under the GIP.
- The taxpayer placed reliance on a Supreme Court decision[4] to support its contention that the disputed income did not accrue or arise in India as the taxpayer did not have any right to claim compensation under the GIP.

Tribunal's observations and order

- On perusal of the respective insurance policy documents, the ITAT observed that the insurance policy taken by the taxpayer was to secure stock in trade (a tangible asset), while the GIP taken by the parent company was for securing investments made in subsidiaries or financial interest in subsidiaries (an intangible asset). Thus, the policy taken by the taxpayer and the policy taken by the parent company were in respect of two different interests being insured.
- The Tribunal noted that even though the loss in economic value of the financial interest, constituting insurable interest in the hands of parent company, was computed with reference to loss of stock by fire, it was still distinct and separate from the insurance claimed by the taxpayer.
- The ITAT agreed with the taxpayer's submissions that the parent company had borne the cost of the GIP in its entirety and no part of the same was cross-charged or allocated to the taxpayer. Further, it agreed that the contract of the GIP was between the

[3] Section 9(1)(i) of the Act

[4] ED Sassoon & Co. Ltd v. CIT [1954] 26 ITR 27(SC)

parent company and the overseas insurer, without the taxpayer being a party to it. Thus, the ITAT accepted the taxpayer's argument that it had no right/obligation under the GIP.

- The ITAT accepted the taxpayer's submissions that the parent company was prohibited by German laws to directly insure the assets of the subsidiary in India and thus, the compensation received under the GIP was for diminution in the financial interest of the parent company after adjusting the loss compensated by the domestic insurer in India.
- The ITAT negated the Department's submissions that the compensation received abroad was income deemed to accrue or arise in India. It accepted the taxpayer's reliance on the SC decision to hold that for income to accrue or arise in India, the taxpayer should have acquired a right to receive the income, which was absent in the instant case.
- Further, it was also opined that the insured interest of the parent company in its subsidiary in India cannot be said to be on account of a business connection in India or through or from any property in India or through or from any asset or source of income in India. Thus, it held that the compensation received abroad did not accrue or arise in India for the purpose of the Act.
- The Tribunal also refuted the Department's contentions that the taxpayer adopted a colourable device for evading taxes in India by receiving compensation abroad. It was observed that the GIP was taken by the parent company in respect of all its subsidiaries world-wide to cover contingent losses that may or may not arise in the future.

Our comments

This ruling by the Tribunal would be useful in case a multinational corporation takes similar insurance covers to safeguard the parent entity's financial interest in its subsidiaries in India. The Tribunal's observation that such an arrangement cannot be considered a colourable device to evade taxes is also a positive development.

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